

# CEO Perquisites and Family Firms



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# Research Question

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- Is CEO's personal use of perks associated with family ownership and management?
- Why study this association?
- Answer unresolved issues in two research streams
  - family firms literature
  - executive compensation literature, including executive perks

# Family Firms Literature

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- Why does it catch attention from academics and media
  - *BusinessWeek* cover (Nov. 10, 2003)
  - Quite prevalent in US (1 out of 3 in S&P500 are “family firms,” defined later), more so in smaller firms
  - % even larger in Asia and Europe (e.g., virtually all local firms listed in HK are family firms)
  - Two interesting agency problems

# Family Firms Literature

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- Two types of agency problems in family firms
  - “Agency Problem I”: between family shareholders and managers:
    - If family members serve as CEO: no agency problems because principal = agent.
    - If CEO is hired from outside: less problems because of monitoring by family shareholders.
  - “Agency Problem II”: between family shareholders and minority shareholders
    - The control by family members enables them to seek private benefits at the expense of minority shareholders.

# Unanswered question in family firms literature

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- What is known so far: there are benefits from family ownership: family firms (in US)
  - Have higher valuation and are more profitable than non-family firms (e.g., Anderson and Reeb, 2003a, Villalonga and Amit, 2006, etc.).
  - Enjoy lower costs of debt (Anderson, Mansi and Reeb, 2003).
  - Engage in less diversification (Anderson and Reeb, 2003b)
  - Provide higher quality financial reporting (Wang, 2006; Ali, Chen and Radhakrishnan 2007)
- ➔ Interpretation: family firms have lower agency problems.

# Unanswered question in family firms literature (Cont'd)

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- Unknown: do family firms have lower agency problems?
  - The superior performance of family firms is driven by founder CEOs → Villalonga and Amit's (2006) interpretation: founder CEOs have low Agency Problems I and II → but founders also tend to possess special skills and better ability (Wasserman, 2004, 2006).
  - No evidence that family firms expropriate minority shareholders (Agency Problem II)
    - Counter evidence: family CEOs are paid less (Gomez-mejia et al. 2003)

# Unanswered question in research on executive perks

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## □ Negative view of perks in media

### ■ Business perks:

“Big Three Automaker CEOs Flew Private Jets to Plead for Public Funds” – *ABC News*, Nov 19, 2008

### ■ Personal perks:

Nicki Mulally (the wife of Ford Motor’s new CEO, Alan Mulally) and her five children can travel on Ford’s corporate jets without her husband – *Wall Street Journal*, June 30 2007

# Unanswered question in research on executive perks (Cont'd)

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- Investors' perspective
  - Market reacted negatively to initial disclosure of personal use of perks (Yermack, 2006)
- Regulators' perspective
  - SEC sanctioned firms for failing to comply with perk disclosure requirement, and
  - adopted a tighter disclosure rule of perks in 2006.
- Researchers' perspective
  - In agency theory literature (Jensen and Meckling, 1976, Grossman and Hart, 1980; Jensen, 1986), CEO perk consumption is used as a representative example of agency problems.

# Unanswered question in research on executive perks (Cont'd)

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- However, no clear empirical evidence showing perks represent expropriation
  - Rajan and Wulf (2006 JFE): perks (both **business** and **personal** uses)
    - are provided to enhance managerial productivity (e.g., corporate jets provided by firms whose headquarters are far away from a major airport)
    - are not related to agency problem variables
  - Yermack (2006 JFE): perks (**personal** use)
    - are not related to agency problem variables
    - (although market reacted negatively to initial disclosure of personal use of perks).

# Contributions of this study

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- Is the use of perks related to measures of agency problems?
- Are family firm variables associated with variables related to perk usage?
- ➔ Providing more evidence of agency problems in family firms

# Definition of perks

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- In compensation studies, executive perquisites refer to non-monetary compensation given to “selected senior officers,” including
  - personal use of corporate aircraft
  - golf or country club membership
  - home or personal security
  - financial or tax counseling
  - etc.

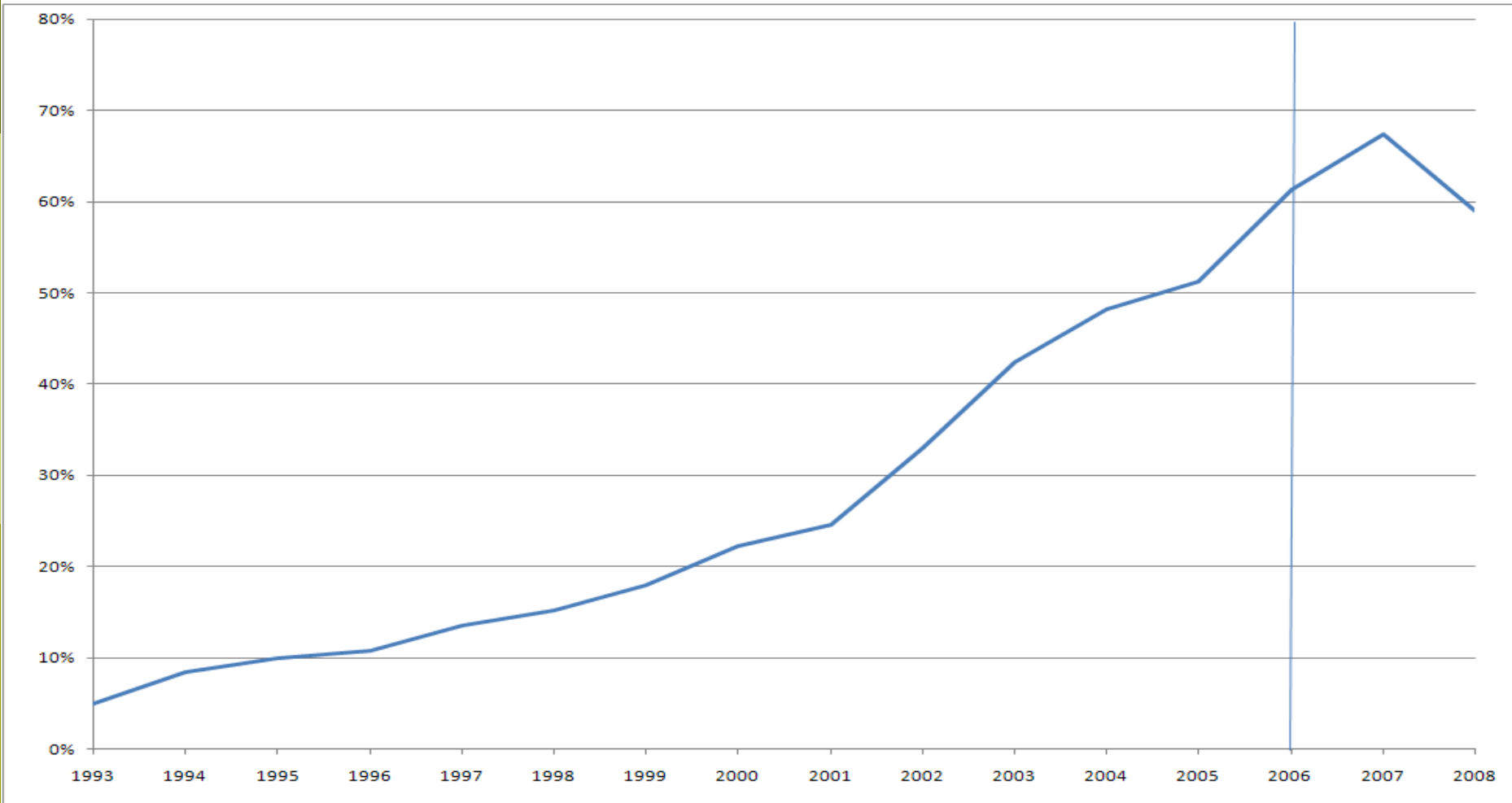
# SEC disclosure rules of perks

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- Up to 2005:
  - *SEC 17 CFR 229.402* “Executive Compensation” requires the disclosure of perks if the total value exceeds the lesser of **\$50,000** or 10% of CEO’s salary plus bonus.
- From 2006:
  - reduced the threshold to **\$10,000**.
- The amount of perks is censored, so we use Tobit regression when examining the amount of CEO perks.

# Figure 1

## Percentage of S&P 500 Firms Reporting Executive Perk Consumption for Personal Use, 1993 to 2008



# Family firm variables

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- Family firms (or family ownership)
  - Definition in literature (and *BusinessWeek*):
    - founder and/or descendants served as the top managers or directors, or
    - family members were among the firm's largest shareholders (usually the largest non-institutional shareholders)
  - 177 firms (35%) in S&P 500 are family firms
  - Median ownership: 11%
- Family management: who serves as CEO?
  - Founder: 76 firms (43% of family firms)
  - Descendent: 29 firms (16%)
  - Hired professional: 72 firms (41%)

**Table 2**  
**Descriptive statistics of CEO perks (1993-2006)**

	Percentage or Mean		
	Family firms	Non-family firms	Difference <sup>b</sup>
<i>Firms disclosing any CEO personal perks (%)</i>	22.3%	27.7%	-4.47***
<i>Among disclosing firms, % of firms whose CEO personal perks include personal use of corporate aircraft</i>	69.4%	68.7%	---
<i>Disclosed amounts of CEO's total perks (natural log)<sup>a</sup></i>	10.97	11.14	-2.92**
<i>Percentage of the cost of personal use of corporate aircraft in total perks</i>	55.6%	54.0%	---
<i>Perks-related information from other sources</i>			
<i>Company owns or leases aircraft (%)</i>	50.3%	68.1%	-3.58***
<i>CEO has golf club membership (%)</i>	17.6%	24.6%	-6.72***
No. of firm-year observations	2,478	4,522	

# Hypothesis development

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- Is perk usage related to measures of agency problems?
  - Re-examination of Yermack (2006), which shows no association
  - Measures of agency problems: excess compensation (Core et al. 1998 JFE) and CEO ownership
  - Difference here: larger sample and longer period
- H1: CEO with excess compensation and lower shareholding are more likely to use personal perks, and they use more when they are offered.

# Yermack (2006) and this paper

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	Yermack (2006 JFE)	This paper
Sample size	<b>237</b> firms in Fortune 500	S&P <b>500</b>
Sample period	<b>1993 – 2002</b>	<b>1993 - 2008</b>
Measures of Agency Problems	<b>1. Excessive compensation</b> <b>2. CEO ownership</b>	<b>1. Excessive compensation</b> <b>2. CEO ownership</b> <b>3. Family firm variables</b>
Focus of perks (from proxy statements)	CEO'S personal use of <b>aircraft</b>	CEO's personal use of <b>all perks</b> (including aircraft)

# Summary of H2-H4

## Relative to non-family firms

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	Family Firms Overall	Founder CEOs	Hired CEOs	Descendent CEOs
H2: use and amount of perks	-	-	-	+
H3: first to use perks in industry	-	-	-	+
H4: cancellation of perks in 2007-08	+	+	+	-

### □ Rationale

- CEO's personal use of perks reflects agency problems
- Family firms face less severe agency problems and
- Founder CEOs create least, whereas descendent <sup>18</sup> CEOs create most severe agency problems.

# Summary of Results

- H1: perk use and amounts are associated with agency problem variables (Tables III and V)
- Relative to non-family firms

	Family Firms Overall	Founder CEOs	Hired CEOs	Descendent CEOs
H2: Use of perks ( <a href="#">Table III</a> )	–	–	–	NS
H2: Amount of perks ( <a href="#">Table V</a> )	–	–	–	NS
H3: First one to use in Industry ( <a href="#">Table VI</a> )	NS	NS	NS	+
H4: Cancellation of perks in 2007-08 ( <a href="#">Table VII</a> )	+	+	NS	NS

**Table III**  
**Probit Regression of the Likelihood of CEO's Consumption of Any Perquisites**

*Panel A: Family vs. Non-family Firms*

Variables	Predicted Sign	Coefficient	z-statistics	Marginal probability
Intercept	?	-1.34**	-2.06	-
<i>FAMILY</i>	-	-0.29***	-2.87	-0.07
<i>EXCESS_COMP</i>	+	0.01***	4.38	0.00
<i>CEO_OWN</i>	-	-0.01***	-3.73	-0.00
<i>SIZE</i>	-	-0.01*	-1.86	-0.00
<i>LEV</i>	?	-0.39	-1.27	-0.09
<i>AGE</i>	-	-0.01	-1.16	-0.00
<i>TOTINST</i>	-	-0.10	-0.54	-0.03
<i>TREND</i>	+	0.18***	17.95	0.04
<i>ROA</i>		-0.03	-0.07	0.01
<i>MB</i>	?	-0.02*	-1.84	-0.00
<i>TENURE</i>	+	0.01	0.96	0.00
Likelihood Ratio		2793.1		
<i>Pseudo R</i> <sup>2</sup>		22.2%		
No. of observations		6009		



**Table III**  
**Probit Regression of the Likelihood of CEO's Consumption of Any Perquisites**

*Panel B: Founder CEOs, Descendent CEOs, and Hired CEOs of Family firms vs. Non-Family Firms*

Variables	Predicted Sign	Coefficient	z-statistics	Marginal probability
Intercept	?	-1.35***	-2.07	-
<i>FOUNDER</i>	-	-0.35**	-2.27	-0.11
<i>DESCENDENT</i>	+	0.27	1.28	0.10
<i>HIRED_CEO</i>	-	-0.27**	-2.23	-0.10
<i>EXCESS_COMP</i>	+	0.01***	4.42	0.00
<i>CEO_OWN</i>	+	-0.01***	-3.87	-0.00
<i>SIZE</i>	-	-0.01	-1.85	-0.00
<i>LEV</i>	?	-0.38	-1.25	-0.09
<i>AGE</i>	-	-0.01	-0.66	-0.00
<i>TOTINST</i>	-	-0.10	-0.52	-0.06
<i>TREND</i>	-	0.18***	18.01	0.05
<i>ROA</i>	+	-0.03	-0.07	0.02
<i>MB</i>	?	-0.02*	-1.82	-0.00
<i>TENURE</i>	+	0.01	1.10	0.00
Likelihood Ratio		2792.5		
Pseudo R <sup>2</sup>		22.2%		
No. of observations		6009		

S.D. adjusted for time and industry clusterings

**Table V**  
**Tobit Regression of the Disclosed Costs of a CEO's Total Perks**

*Panel A: Family vs. Non-Family Firms*

Variables	Predicted Sign	Coefficient	t-statistics
Intercept	?	-5.43**	-2.24
<i>FAMILY</i>	-	-1.19***	-3.00
<i>EXCESS_COMP</i>	+	0.01***	5.09
<i>CEO_OWN</i>	-	-0.01***	-3.64
<i>SIZE</i>	-	-0.01**	2.08
<i>LEV</i>	?	-1.33	1.08
<i>AGE</i>	-	-0.01	-0.44
<i>TOTINST</i>	-	-0.40	-0.54
<i>TREND</i>	-	0.72***	17.79
<i>ROA</i>	+	-0.38	-0.20
<i>MB</i>	?	-0.07*	-1.77
<i>TENURE</i>	+	0.03	1.13
<i>Adjusted R<sup>2</sup></i>		11.2%	
<i>N</i>		6009	

**Table V**  
**Tobit Regression of the Disclosed Costs of a CEO's Total Perks**

*Panel B: Founder CEOs, Descendent CEOs, and Hired CEOs of Family Firms vs. Non-Family Firms*

Variables	Predicted Sign	Coefficient	z-statistics
Intercept	?	-5.44**	-2.25
<i>FOUNDER</i>	-	-1.42***	-2.27
<i>DESCENDENT</i>	+	1.11	1.33
<i>HIRED_CEO</i>	-	-1.10**	-2.35
<i>EXCESS_COMP</i>	+	0.01***	5.10
<i>CEO_OWN</i>	-	-0.01***	-3.73
<i>SIZE</i>	-	-0.01**	-2.06
<i>LEV</i>	?	-1.31	-1.07
<i>AGE</i>	-	-0.01	-0.45
<i>TOTINST</i>	-	-0.38	-0.52
<i>TREND</i>	-	0.72***	17.81
<i>ROA</i>	+	-0.38	-0.20
<i>MB</i>	?	-0.07*	-1.75
<i>TENURE</i>	+	0.03	1.21
Pseudo R <sup>2</sup>		11.2%	
<i>N</i>		6009	

# Table VI

## Leader and followers of perk usage within industry

	Founder CEO	Hired CEO	Descendent CEO	Non-family CEO
First user of perk	10 (13.16%)	11 (15.28%)	7 (24.14%)**	36 (11.11%)
Follower of perk usage	40 (52.63%)	38 (52.78%)	13 (44.83%)	228 (70.59%)
Never use perk	26 (34.21%)	23 (31.94%)	9 (31.03%)	59 (18.3%)
Total	76 (100%)	72 (100%)	29 (100%)	323 (100%)

# Table VII

## Cancellation of perks in 2007-08

	Founder CEO	Hired CEO	Descendent CEO	Non-family firms
Firms cancelling perks in 2007-08	17 (34%)***	7 (14.28%)	6 (30%)	44 (16.67%)
Number of perk users in 2006 or 2007	50 (100%)	49 (100%)	20 (100%)	264 (100%)

# Voluntary disclosure of perks and family firms

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- What is voluntary perk disclosure?
  - Before 2006, disclosure necessary if personal perks > \$50k
  - Starting from 2006, the threshold was reduced to \$10k
  - In 2005, 71 firms disclosed perks < \$50k → voluntary
  - In 2006, additional 68 firms disclosed perks < \$50k for the first time → “forced disclosure”

## Table VIII

### Voluntary perk disclosure in 2006

	Founder CEO	Hired CEO	Descendent CEO	Non-family firms
(1) Voluntary disclosure of perks in 2005	6 (60%)	17 (63.0%)	4 (36.4%)	44 (48.4%)
(2) "Forced" disclosure of perks in 2006	4 (40%)	10 (37.0%)	7 (63.6%)	47 (51.6%)
Difference in (1) & (2)	20%	25.92%	-27.28%	-3.30%
Number of firms with perks less than \$50000 in 2005 and 2006	10	27	11	91

#### □ Implication

- Founder and hired CEOs are more likely (NS) to voluntarily disclose perk use → no bias in results<sup>27</sup>

# Robustness Tests

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- S.D. adjusted for both firm and time clusterings
- Fama-MacBeth approach
  - Annual regressions
  - Test significance of mean of annual coefficients
- Hazard model
  - Model dependent variable (disclosure of perks) as survival time
- Censored perks amount to \$50k (due to disclosure threshold prior to 2006)
- Results generally hold up

# Conclusions and Contributions

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- Provide evidence that CEO personal use of perks is indication of agency problems
  - Excessive compensation and CEO ownership are determinants of CEO's perk consumption
  
- Provide more direct evidence on the relation between family ownership and agency problems
  - Family firms provides less personal perks to CEOs
  - Founder and hired-CEOs get less personal perks
  - Descendant-CEOs more likely to be first in industry to get perks for personal use
  - Founder CEOs more likely to cancel perks in economic downturn

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Q&A

Thank You!